July 25, 1935

INCOME AND INCOME TAXES

In general terms the problem was to investigate into the ratio between what persons of large wealth have taken out of the social product and what they have contributed to the support of government in the way of income taxes. Specifically the problem divided itself into a method of finding out who the persons of wealth were who should be the subject matter of the investigation and then examining into particular devices used by them to cut down the amounts of their tax payments. It was decided to gather information for several years, where available, but to make the year 1932 a standard of comparison for the reason that that is the latest year for which full returns have been received and largely audited and revised.

The investigation is roughly divisible into four subjects:

I. Tax Exempt Securities as a Device for Tax Avoidance

II. Hobbies as Businesses for Tax Purposes

III.

IV. Tax Histories of Various Individuals Reputed to be Wealthy

I. TAX EXEMPT SECURITIES AS A DEVICE FOR TAX AVOIDANCE

An obvious and presumably simple means of tax avoidance is suggested in the tax exempt securities device. In the case of the

individual it is not merely a means of avoiding taxes but a means also of cutting surtaxes. In the case of a corporation, subject to a single tax rate, the picture is somewhat different. It seemed advisable to consider separately, among corporations, banks, industrial corporations, public utilities and railroads.

It should be kept in mind that information as to tax exempts is obtained from the face of the returns and not from any independent examination. In view of the fact that the information does not, in most cases, have any bearing on the quantum of tax, many taxpayers simply refrain from giving the information and revenue agents make no point of it in their reports. There is, therefore, no guarantee that the figures given are in each case accurate, nor can it be truthfully said that each taxpayer showing no tax exempt income on his return does in fact have none. On the contrary, the Mellons, for example, never disclosed their tax exempt income, and another taxpayer in one instance wrote in the space reserved in his return for that information that he had no room to give it.

In the case of corporations, however, it is more probable that the tax exempt information is accurate, for the returns were usually accompanied by or checked by reference to balance sheets in which reconciliation must be made between the taxable income and the total income.

In view of the fact that the information with regard to individuals, for reasons above mentioned, was taken chiefly as of 1932, calcula-

tions as to potential tax lost (13¾% of the tax exempt income in the case of corporations) were taken for 1932. Figures were given, where they seemed relevant and were available, in the cases of corporations for the years 1928 through 1934. The corporate figures, however, were not revised or audited, being based entirely on the transcripts of returns made by the Statistical Section. It is not believed, however, that with regard to the item of tax exempt income the revision would necessitate any substantial changes. The pressure of time made examination of the individual returns in these cases impractical.

1. Tax Exempt Securities Held by Individuals (Chart Ia)

Chart (Ia) is devoted to an analysis of returns of all individuals showing a gross income of $1,000,000 or over for the year 1932. It is conceivable - though not probable - that there are additional persons who have an actual gross income of $1,000,000 or over and whose names do not appear in this list. This is accounted for by the fact that the Statistical Section of the Income Tax Unit classifies such information by net income rather than by gross income, and then only insofar as these data are disclosed on the face of the original return filed by the taxpayer. The Statistical Section therefore takes no account of the gross income nor of any subsequent revisions of the original return in the field or in the Bureau, nor of the nature of the deductions from it as shown on the return.

It is possible to obtain in the Statistical Section transcripts of the returns of persons having an income of $100,000 or over, divisible

into classes of $100,000 to $500,000, $500,000 to $750,000, etc. An examination was made of the transcripts of the returns of persons reporting a net income of $100,000 or over and among these 58 persons were found who in 1932 reported a gross income of $1,000,000 or over. The Statistics of Income for 1932, made up by the Statistical Section, showed only that 20 persons had a net income of $1,000,000 or over for that year.

The returns and the accompanying files of these 58 persons were examined and calculations made to ascertain the extent to which income from tax exempt securities actually went untaxed; that is to say, how much was lost in individual cases from surtaxes and the extent to which such persons contributed on the basis of their other income to the support of the government. The information obtained is contained in Chart (Xa). That chart contains several instances, as will be seen, in which practically no tax was paid by persons whose net taxable income placed them in a very low bracket but whose tax exempt income placed them in the millionaire class.

The chart shows that as against $24,429,565 of taxes actually received from (or assessed against) these fifty-eight taxpayers, at least almost half as much in addition ($11,866,951) could have been received if the tax exempt feature of securities had not been present. No account is taken at this point of the argument that a higher interest rate on Government securities would be necessitated by the abolition of tax exemption.

Interesting conclusions - not, however, directly relevant to the tax exempt question proper - may be drawn from this chart and the key to it with regard to the distribution of wealth in this country. The year 1932 was perhaps a good year for such a purpose inasmuch as capital gains were not present in any measure comparable to the pre-depression period. Hence, although we find a comparatively lower average income among the very rich, that income nevertheless represents investment return, largely from dividends, manifesting a fixed share of more or less normal productive wealth. A comparison with 1931 and 1933, however, indicates that as to a few very wealthy persons unusual circumstances not affecting their permanent status accounted for a reduction in income for 1932; for example, one individual who controls a large enterprise simply took no dividends during that year.

The key will disclose that most of these 58 individuals fall into 30 families, at least one accounting for as many as five individuals and two others for at least four a piece. This, of course, takes no account of individual incomes of under $1,000,000 derived from trusts controlled by or managed in common with these 58 fortunes. In fact several of these 58 incomes appear to be derived in the first instance from trust funds - indicating (as a further conclusion) an even greater concentration of wealth - a subject which deserves, possibly, separate study.

The key will further disclose that most of the fortunes tied up in these families are derived mainly from single enterprises, and the

nature of those enterprises gives food for thought. For example, at least two of them are national retail merchandising enterprises, a more recent phenomenon in the United States accounting for the lack of traditional social position on the part of these families; railroad fortunes on the other hand appear to have been mostly somewhat dissipated since their accumulation in the course of the latter half of the last century.

2. Life Insurance Companies (Chart Ib)

The largest investors in tax exempt securities, it would seem, are insurance companies; for lack of time no investigation was made, however, into the large foundations and institutions. Insurance companies were chosen which reported (in "Weekly Underwriter") total assets of $500,000,000 or over as of December 31, 1934. All the companies meeting this test turned out to be life insurance companies and amounted to ten in number. The information with regard to them, and with regard to an eleventh added for illustrative purposes, is contained on Chart (Ib).

3. Commercial Banks (Chart Ic)

Moody's Banking Manual for 1934 contains a list of commercial banks in terms of their resources. In order to find out to what extent banks have been investing in tax exempt securities the list for commercial banks with resources of $100,000,000 or over was taken; they number 65. The information found, based practically entirely on the returns themselves as contained on the transcripts in the Statistical Section, supplemented in many cases by information apparently not found by the Statistical Division but contained, nevertheless, in the returns and files of the

company, is set forth in Chart (Ic). It will be seen that in these cases tax exempt income has often proved very desirable. While in the case of the insurance company it was the necessity for assured income rather than the tax exempt feature that in the first instance probably motivated the investment, in the case of banks the simple profit feature would seem much more dominant. Just as in the case of several insurance companies, we found that the tax exempt income more than wiped out net losses, in the case of commercial banks similar conclusions may be drawn.

Difficulty was experienced in the case of the returns of these commercial banks, both by failure in many cases on the part of the Statistical Division to discover the information (usually because of a failure on the part of the taxpayer to list the information in the place where it belonged) as well as by the making of consolidated returns by parent holding companies. The latter cases involved allocation of tax exempt income although the amount of tax paid is determined after the consolidation of the income and the losses of many more affiliated units consisting, usually, of other banks.

Nevertheless, it is possible to draw the conclusion that a potential tax of all these 65 banks, of about $12,000,000 each year is lost through the existence of tax exempt securities. It will be noted that in 1932 all these banks together paid considerable less than

$500,000 in taxes. The $12,000,000 figure would tend to be partially reduced and certainly affected by the setting off of other losses of affiliated banks in the case of consolidated returns and tend to be increased by those instances in which accurate information is lacking. It may be mentioned that the banks have exercised the legislative permission given them to charge off their management and servicing expenses against taxable income, not including their tax exempt income; a form of favoritism to the banks for which justification is at least somewhat doubtful.

4. Industrial Corporations (Chart Id)

The transcripts of returns for industrial corporations showing a total invested capital for 1932 of $100,000,000 and over, as shown by Standard Statistics, were examined. 70 such corporations were found and the information with regard to them is set out in Chart (Id). Inasmuch as tax exempt holdings seemed small in 1932, information was not taken down for any year but that one. The chart shows the investment in tax exempt securities - being largely of surplus cash - is not so great as in the case of insurance companies or banks. There are, however, several large corporations that do have substantial tax exempt income resulting in substantial tax savings. The total tax exempt income as disclosed for the 70 corporations is therefore at least in the neighborhood of $23,500,000, making the potential annual tax lost, based on 1932, at least about $3,300,000. The total tax paid for these 70 corporations (as shown by the returns) for 1932 was about $27,000,000, largely made up, however, of

profits of corporations whose tax exempt income was small.

5. Public Utilities and Railroads (Chart Ie)

A separate calculation was made for public utilities and railroads. It was advisable to take those public utility companies showing total invested capital of $800,000,000 and over, and those railroads showing $1,000,000,000 and over, as reported by Standard Statistics. There were six public utilities meeting this test and five railroads. The total amount of tax exempt income is comparatively small. In the case of public utilities only one company showed in 1932 a large tax exempt income (of over $5,000,000) and in the case of railroads, only two showed tax exempt income of over $1,000,000.

CONCLUSIONS WITH REGARD TO TAX EXEMPTION

From the information gathered these conclusions may be drawn:

First, from a tax standpoint, the existence of tax exemption is probably not justified by the arguments in its favor. The individuals who profit by tax exemption are those who would be otherwise found in the very high surtax brackets. The wealthier they are, the greater the advantage in the further sense that large fortunes invested in tax exemption are both safer and available for assured total annual incomes in satisfyingly large amounts.

Second, in the case of business corporations, it is clear that those invest largely in tax exempt securities who must be assured of a certain constant income; the others are merely drawing cash from the business or enterprise for the purpose of attractive investment. In such cases, as

exemplified by life insurance companies, it is not so much the tax exemption that is attractive as the certainty that recurring obligations (like policies) can be paid when they fall due, that interest charges can be met, etc.; the fact that the interest rate paid on such securities might perhaps be smaller or larger, depending on the existence of tax exemption is chiefly of actuarial significance, affecting only the fixing of premiums, etc.

II. HOBBIES AS BUSINESSES FOR TAX PURPOSES (CHART II)

It was discovered in the course of the examination into the returns of various individuals that large losses were claimed - and allowed in most cases - both as deductions from net income (which would be apparent on the face of the return) and as reducing general business income (which often would not be apparent on the face of the return), where the losses were incurred in the operation of racing stables, cattle and horse breeding farms, etc. It was obvious that these enterprises, usually operated at a constant loss over a period of years, were rich men's hobbies and that the fact that the hobby, in form, was carried on along business lines was availed of to reduce taxable net income.

There is no certain routine means of discovering these outstanding cases. The income tax return does, it is true, call for the statement of the taxpayer's occupation, but it does not necessarily follow either that the taxpayer will claim his occupation to be that of a farmer or that if he does there will be any tax losses involved. The

assumption is that a taxpayer may have several different businesses; and there is no compulsion to insert the time, or for that matter, any occupation, in the blank reserved for it in the return. It was therefore necessary to examine all those in the net income class of $100,000 or over who had listed themselves as farmers, innkeepers, etc., and to examine cases on the allowability of such losses which had come through the Conference Section in the Income Tax Unit. Chart II is the result.

Each of the 35 individuals listed on Chart II received his income from and, in most of the cases, devoted his time to some other occupation. In some instances, however, such hobbies as operating racing stables may account for a large portion of the time of an individual who receives his income, without any appreciable expenditure of effort, from estates or trust funds.

It may be added that while the case of Thacher v. Lowe, 288 Fed. 994, decided by Judge Learned Hand in 1922, gave the Bureau some basis for disallowing such losses on the ground that the enterprise, although stated by the taxpayer to be operated for a profit, showed a nonprofit history, most cases have been decided the other way, usually on the sworn testimony of the taxpayer that he intended to make the business profitable and upon evidence that books were kept, sales were made, etc. The fact that, naturally, every wealthy man would keep a set of books to know where he stood and would attempt to make a profit if he could, seems to have had no influence over the courts. It may be pointed out that two of the outstanding cases permitting deduction were decided by Judge Manton in the

Circuit Court of Appeals in the 2nd Circuit - Wilson v. Eisner, 282 Fed. 38, and Commissioner v. Marshall Field, 67 Fed. 2nd 876. As a result the Bureau has allowed losses in a case (#3 in Chart F) where for a period of over twenty years the taxpayer showed an average annual net loss of $184,000, simply because the enterprise (raising pedigreed animals, etc.) was carried on with a set of books, purchases and sales, etc.

Two alternative remedies are suggested to cure this evil. One would be to compel the taxpayer to segregate such enterprises permitting losses only to the extent of profits. The other would be to disallow them entirely as losses and to regard the profits as income. The test might be made to be the receipt of some large proportion (say 70%) of the gross income for an average preceding period (say about three years) from investments or the exercise of a trade, business or profession. The occupations for which losses should be disallowed should be definitely itemized as including the operation of a farm, racing stable, cattle and horse breeding, etc. It is not advisable to make the amount of time spent by the taxpayer a test of what his business is. An exception might be considered in favor of a person showing uninterrupted profits for a continuous period in the immediate past (say the preceding three years) from such an enterprise, and other efforts of deliberate business interest clearly demonstrating the enterprise to be an additional business operation by the taxpayer and not a hobby or a show of wealth.

August 13, 1935

III. THE DU PONT FAMILY TAX HISTORY

It was desired to study the use of trusts and other legal artificial entities by the wealthy as devices for avoiding certain limitations on tax reduction, such as trusts for the maintenance and support of wives, children and other dependents avoiding the limitation of $2,500 (plus $400 for each dependent) applicable to ordinary taxpayers, and trusts for quasi-charitable purposes avoiding the 15% limitation on charitable contributions and the complete disallowance of quasi-charitable contributions (like payments to "needy individuals", etc.).

A systematic study of the use of these devices by wealthy persons, however, did not prove promising for there is no routine way in which such information can be obtained and it was not deemed advisable to make any wide-spread inquiry among the Bureau personnel. It was decided instead to make a sample study of the tax history of the Du Pont family and especially of those Du Ponts and their relatives and friends who together control Du Pont and General Motors.

Investigation was made, therefore, of the Du Pont family tree, of the nature of the Du Pont financial interests, of agents' reports, income tax returns and statistical information in the Bureau, and a supplementary study was made of the files of the Agent in Charge in Baltimore. The tentative results are contained in 11 charts, III(a) to III(k) inclusive.

1. Du Pont Trusts (Chart III(a))

The Agent in Charge in Baltimore, it turned out, had two file drawers with reports and returns for the Du Ponts. The contents of these

two drawers indicated 200 separate returns were filed under that name alone, the returns of the married daughters and their families being omitted. The indications were, therefore, that the Du Pont family had split its gross income on a very large scale by the use of trust devices so that individual beneficiaries and trustees were filing separate returns as though they were individual taxpayers. Of course, where the same person received income from several sources, such as several trusts, he could not avoid surtaxes simply by having separate returns. But the grantors of these trusts could retain the beneficial advantages of wealth and escape the burden of taxation to a large extent by the device of breaking up the income and diverting it to separate entities.

Chart III(a) is a working chart not completed. It is in the form of a family tree of the main Du Ponts. The tree is derived largely from a Du Pont family tree published in the November, 1934, issue of "Fortune", as supplemented by an investigation which I had made into newspaper accounts, genealogical information at the Congressional Library, etc. The information incorporated in this chart is to a large extent solely that contained in the Statistical Unit of the Bureau of Internal Revenue; hence it is in the main limited to reputed annual net taxable incomes of over $100,000. It results that Du Ponts (undoubtedly a good many) who receive less than that a year have been probably omitted. The significance of the information is also limited by the fact that the Statistical Unit does not go beyond the face of the Form 1040 returns filed by the taxpayer.

The chart speaks for itself. But among the interesting things to be noted are the evidences of the trust funds and the very large incomes apparently received by - or for - minor children.

2. <u>The 7 Dominating Individuals (Charts III(b) to III(i) incl.)</u>

The material found in the Bureau files was voluminous in the sense that so many individual persons and so many individual entities (taxpayers, beneficiaries, guardians, trustees, etc.) were concerned, but was most sketchy and unsatisfactory in the sense that details of the various trust provisions, the nature and the amount of the corpus, and other very relevant information could not be found. It was therefore deemed inadvisable to make any further detailed study of all the many Du Ponts, their relatives and their friends. Instead it was decided to study more closely those who might be said to control the Du Pont enterprises. This reduced the list of persons to seven - five Du Ponts, one Du Pont in-law, and Raskob. The basis for this selection was largely the articles describing the Du Pont family history published in "Fortune" for November and December, 1934, and January, 1935. In those articles (and the conclusion is reenforced by an examination of the tax history) it was, in substance, stated that the most important Du Pont for our purposes was Pierre S., and with him in the control of the business were his younger brothers, Irenee and Lammot, and to a certain extent his cousins, Henry F. and A. Felix, and his brother-in-law, R. R. M. Carpenter, and his life-long friend and business associate, John J. Raskob. This omits from the study Alfred I., recently deceased, who had a very large interest in the Du Pont business, but who was squeezed out of control of the Du Pont

companies several years ago. It also excludes a goodly number of other Du Ponts who have interests in the business but no important participation in the management.

(a) The Composite Tax History (Chart III(b))

As the study progressed it seemed clear that these seven persons had by questionable methods (in some cases making them open to fraud charges) avoided taxes and surtaxes. A summary chart of a very tentative nature was prepared in the form of a graph (Chart III(b)). This graph tends to indicate (although the conclusion when the graph is considered alone is admittedly debatable) that these seven persons have consistently avoided the full impact of the surtax system.

It was assumed that the chief sources of income for these seven people were the dividends paid by General Motors and E. I. du Pont de Nemours. This in itself is perhaps a questionable statement since it fails to take full account of the large capital gains, among other items, that suggest themselves. The composite dividend history of the two companies from 1914 to 1932 is shown in the first grid on the chart.

The second grid shows the composite reported net incomes of these seven persons for the years for which information was available. These figures are not revised, being solely those contained in the Statistical Unit. It is to be noted that there is a substantial amount of fictitiousness involved in the merging of the reported taxable income of some of the seven with the reported losses of others.

The third grid is the essential one. On one hand it shows the reported taxes paid for the same period - 1914 to 1932. On the other hand an attempt has been made to summarize the additional taxes that would have been paid had the trust devices, tax exempt income and the hobby losses been disallowed for the years 1928 to 1932. It will be seen that the composite additional taxes would be about 1/4 of the amount paid. The figures used are the revised ones; that is, they take account of overassessments and additional assessments for the years in question. The information for years prior to 1928 was so sketchy that it was not deemed advisable to present that information graphically.

(b) Pierre S. du Pont (Chart III(c))

While Pierre S. du Pont, the oldest of the brothers and the head of the family, is childless, his trusts appear to be the most glaring instances of tax avoidance. The uses of the trust devices in his case bear the most obvious evidences of studious tax avoidance. Attention is called to the chart itself - and especially to the footnotes - for details; the reading repays. By means of five trusts he has succeeded in saving for the years 1928 to 1932 alone, $1,275,000 in taxes (that is, including surtaxes).

(c) Irenee du Pont (Chart III(d))

Irenee is the father of nine children, for each of whom he has established trusts. These trusts were established when the children were minors. Their terms, so far as ascertainable, are indicated on the chart (III(d)). It is clear that the taxable income of Irenee du Pont's wealth has been

broken up so that he both retains the advantages of wealth and yet breaks down his surtaxes by segregating (or, rather, distinguishing) portions of his enormous wealth for the recurrent and usual expenses of support, maintenance and education of his family. For the years 1928 to 1932 it is calculated that he has in this way saved at least $951,933 in taxes (that is, including surtaxes).

With regard to this chart as well as some of the following charts, it is to be kept in mind that in the case of a trust the Bureau considers as separate taxpayers the beneficiary, to the extent that he actually receives income and the trustee to the extent that he does not distribute income. In other words, where the trustee has the discretion of distributing or not distributing, accumulation is permitted by the trustee; to that extent the surtax burden is avoided once again.

(d) Lammot du Pont (Chart III(e))

Lammot du Pont, who is now the active manager of the Du Pont enterprises, has had four wives and nine children. He has established trusts for eight of these children, his last child having been born about a year ago. Lammot, it turns out, has worked with his brother Irenee in such a way that their trust devices interlock. The charts indicate the extent of some of this interlocking. It would appear that Lammot has at least 19 different trusts of which the beneficiaries are chiefly minors, and in these 19 trusts there are separate taxable entities totalling about 29, resulting in a total estimated minimum saving from taxes (that is, including surtaxes) for the years 1928 to 1932 of $390,022.

(e) Henry F. du Pont (Chart III(f))

Henry F. du Pont, second cousin of Pierre S., Irenee and Lammot, appears to have a considerable interest in the Christiana Securities Co., insiders' company controlling Du Pont and General Motors. For that reason he was included in this study. He, too, appears to have created a series of trusts on behalf of his children and his wife. It is estimated that he saved for the years 1928 to 1932, at least $237,703 in taxes (that is, including surtaxes).

It will be noted from the chart in this case, as must have been noted also in the prior charts, that there is a large amount of information missing in the agent's reports and in the files generally with regard to the terms and other features of the trusts mentioned.

(f) A. Felix du Pont (Chart III(g))

A. Felix is another distant cousin who appears to be an insider. Information with regard to his trusts is very meager, but for the two years for which there is slight information, a saving of at least $24,853 is indicated.

(g) R. R. M. Carpenter (Chart III(h))

R. R. M. Carpenter is married to a sister of Pierre S., Irenee and Lammot and, with several members of his family, has apparently played an important part in the Du Pont - General Motors business. His chart (III(h)) shows a series of at least 13 trusts for the benefit of his wife and his children and several other persons who may or may not be relatives. For the years 1928 to 1932 a minimum saving in taxes (that is, including surtaxes) is computed of $194,066.

(h) John J. Raskob (Chart III(i))

John J. Raskob is not a Du Pont relative but has long been associated with Pierre S. du Pont, whose secretary he originally was; he is to be considered a Du Pont insider and appears to have a large interest in Christiana Securities Co. However, no trusts were found (which doesn't mean that no trusts exist) for the Raskobs, of whom there are a goodly number. His tax history, however, is none the less checkered. There is a case pending in the Bureau showing wash sales of very large magnitude, for the purpose of claiming capital losses, engaged in between him and Pierre S. du Pont and between him and various members of his family.

(i) Summary of Taxes Saved (Chart III(j))

On the basis of the information available it is computed that these seven individuals for the years 1928 to 1932, as against $13,513,304 in taxes paid, saved, chiefly by the device of trusts, $3,360,768. This figure would undoubtedly be increased if more information were available with regard to tax exempt income and if a computation were made of losses by the device of wash sales so far not set aside.

3. Du Pont Personal Holding Companies (Chart III(k))

A cursory examination was made of the returns of four more or less personal Du Pont companies. This personal element is found to a varying degree. In the case of the Wilmington Trust Co., which is dominated by the Du Ponts, it is undoubtedly true there are a large number of outside but probably financially insignificant stockholders. In the case of the Christiana Securities Co., which was originally formed to take over the

holdings of T. Coleman du Pont (the subject matter of protracted litigation in the Du Pont family, resulting in the ousting of Alfred I. from Du Pont management), there are probably a larger number of insiders than in the usual personal holding company. It is not improbable that several of the younger officers and directors have small interests. In any event, it would seem a justifiable conclusion from the figures shown that in the case of Christiana Securities Co. there has been a cautious piling up of surplus (taxable, therefore, only at corporate rates) with a sufficient declaration of dividends to avoid the charge of excessive accumulation.

That conclusion may likewise be drawn with regard to Delaware Realty & Investment Co., essentially a personal holding company of Pierre S. du Pont, but in which there are apparently enough additional Du Ponts to becloud the situation.

The Saint Amour Co. was a device used by Lammot du Pont for tax avoidance. It is no longer in existence, but during its brief existence it managed to receive a gross income of close to $3,000,000 and paid out in dividends probably under $400,000.

4. Conclusion

Of the several conclusions that may be drawn from the above certainly the outstanding one, it would seem, is the fact that the juridical entity has been permitted to create a glaring inequality between the wealthy and the less wealthy. Theoretically, it is possible for a person of sufficient wealth to obtain tax exemption (that is, chiefly surtaxes) by the simple

device of segregating assets to pay for recurrent personal expenses. Indeed, by retaining powers of substitution of assets, direction of investment, voting power, and providing for reversions and for descent of the corpus, the wealthy man not only obtains exemption but suffers practically none of the disadvantages that might be expected to inhere in a segregation of assets.

The ordinary and less wealthy person is disallowed the ordinary expenses involved in caring for his wife and his children, nor can he obtain the prestige of charitable and quasi-charitable contributions without at the same time including the amount of such contributions in his taxable income.

From a long time point of view I think that is the most serious of the causes of inequality. I have made several recommendations on the subject in a separate memorandum.

IV. TAX HISTORY OF VARIOUS WEALTHY PERSONS (Charts IV. and Misc.)

In considering the problem before us it was thought profitable to study the tax histories of a representative number of persons reputed to be among the wealthiest in the country. It is difficult to build up such a list, for obvious reasons. The final solution is indicated separately in a memorandum entitled "Wealth By Reputation". As that memorandum indicates, the list of persons was chosen from the dominating officers and directors of the largest enterprises in the United States, to which were added the names of persons considered representative of well-known wealthy families. This

list turned out to be unworkable because of the large number of names contained. A smaller list of somewhat less than 200 was then made up out of the larger one. The records of the Statistical Unit of the Bureau of Internal Revenue were then searched for the tax histories of these individuals and a chart was made up showing their reported net taxable income and the reported tax paid for the years 1928 to 1932 (Chart IV).

After consultation this list was again reduced to a little over 50 names, chiefly of persons whose tax histories had not been the subject of an investigation before (as, for instance, by the Pecora Committee) and whose Statistical Unit tax history seemed to call for deeper investigation.

The income tax returns of these persons for several years back and the agents' reports and other material in the files connected with them were examined and the details and explanation of the tax history were reported separately for each individual involved.

The information has not been reduced in the form of a chart because of its tentative nature. It is possible, however, to draw certain conclusions from that study. Some of these conclusions are:

1. The files are far from complete in relevant information. Agents do not make it a practice to give details, such as the terms of trust instruments (this was noted especially in the Du Pont cases discussed above). The conclusion seems unavoidable that in a substantial number of cases insufficient time was spent by agents in the examination of these individual returns. For example, while it was frequently stated that sales of securities obviously made for the purpose of declaring a taxable loss were traced

to brokers' books and verified, the subsequent history of these securities was not thoroughly investigated. It seems especially improbable that sales by such wealthy persons of stock in companies which they control would be entered into except under circumstances that prevented the stock from coming into the hands of strangers. On the other hand, it was quite true that until the Mitchell case, this subject was not considered a particularly fruitful one.

2. The most usual explanation for the absence of proportionate tax payments by the wealthy people examined is in the allowance of capital losses. This is a subject which has been presumably largely taken care of by the 1934 Act.

3. The use of personal holding corporations seems an apparent tax avoidance device. Several individuals were noted who appear to have engaged in complicated transactions with personal holding companies incorporated in foreign countries, for no other apparent purpose than tax avoidance.

4. It seems a justified conclusion that the manipulation by these wealthy people is largely done through hired and possibly, in some cases, full time tax men. The chances of successful prosecution against such taxpayers for crime or fraud are very much limited by the fact that they often do not sign their returns but arrange for agents to sign them. This, of course, removes the state-of-mind element.

Samuel Klaus